



FACSIMILE

November 30, 2005

To: Honorable Elizabeth O'Donnell

Fax: 502-564-3460

From: Gary Smith

Fax: 270-685-8052

Phone: 270-685-8024

Pages: 8

RECEIVED

DEC 01 2005

PUBLIC SERVICE
COMMISSION

Subject:

Comments: The original will be sent via Fed-Ex for delivery tomorrow morning.

URGENT FOR REVIEW PLEASE COMMENT PLEASE REPLY PLEASE RECYCLE



November 30, 2005

Elizabeth O'Donnell
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
P O Box 615
Frankfort, Kentucky 40602

RECEIVED

DEC 02 2005

PUBLIC SERVICE
COMMISSION

Subject: KPSC Case No. 2005-00175
Interim Hedging Report

Dear Ms. O'Donnell:

Enclosed herein are one original and ten copies of Atmos Energy's interim hedging report for the 2004-2005 winter heating season as required by the Commission's Order dated July 20, 2005 in the above-referenced proceeding.

Please contact me at your earliest convenience (270-685-8024) should the Commission or staff have any questions regarding the enclosed report.

Sincerely,

A handwritten signature in black ink, appearing to read "Gary L. Smith".

Gary L. Smith
Vice President, Marketing & Regulatory Affairs

Enclosures

Cc: Elizabeth E. Blackford, Office of the Attorney General
Randy Hutchinson
Doug Walther

**ATMOS ENERGY CORPORATION
KENTUCKY DIVISION
INTERIM HEDGING REPORT
CASE NO. 2005-00175**

The Kentucky Public Service Commission ("Commission") requested in its Order in Case No. 2005-00175 that Atmos Energy Corporation ("Company") provide the Commission with an interim hedging report within thirty days following November 1, 2005. The report is to follow the requirements established in previous Cases pertaining to Atmos Energy's hedging programs, providing "a brief narrative discussion of the factors that influenced the Company's purchasing decisions, including, but not limited to:

- (1) futures prices at the time of purchasing decisions;
- (2) market price trends at the time of purchasing decisions;
- (3) market price forecasts at the time of purchasing decisions; and
- (4) nationwide storage levels, and the Company's own on-system storage levels, at the time of purchasing decisions."

Additionally, the Commission requested a data summary of all hedging transactions and the accounting entries for those transactions, which are normally attached and filed as part of this report. As the following discussion will describe, the increased availability of company storage, the extraordinary impact on natural gas market prices of back-to-back hurricanes, and the rather short hedging implementation period provided few opportunities to acquire financial hedges at reasonable levels. Consequently, the Company did not purchase financial hedges for Winter 2005-2006. Since no financial hedges were implemented this report does not include a summary of hedging transactions or accounting entries.

Atmos Energy's Hedging Strategy

The Company's management, based upon its experiences the past five winters and direction from the Commission, developed the following set of parameters under which a hedging program would be initiated for the winter of 2005-2006. The parameters, as set forth below, were put into place before the implementation period began.

- (a) Based on the Company's supply plan for the winter of 2005-2006 requirements, the Company would purchase financial hedging instruments to stabilize gas prices within a range of 0% up to 25% of its total requirements.
- (b) Hedging purchases would be made during the period following the Commission's July 20, 2005 Order in this Case and through the month of October 2005. This would allow the Company to weight the price across the projected purchase period. Following the Commission's guidance, the Company would use its judgment on market conditions and trends to adjust the timing and volumes of hedge instrument purchases. Specifically, the guidance the Company adheres to is to monitor the

market during periods of declining prices, and then consider executing hedges during following a trend of upward pricing. The Company would purchase futures contracts and possibly options on futures contracts to stabilize prices in a reasonable range, realizing that achieving the lowest price at any given time was not likely.

- (c) The Company determined that controlling price risk to prevent price spikes similar to those which were seen in the winters of 2000-2001 and 2002-2003 is the primary objective of its hedging policy. The Commission, in its previous hedging Orders has acknowledged that the goal of a hedging program is "to provide insurance against an event such as price spikes", not necessarily the lowest cost. The futures contracts would allow the Company to set a fixed price which would hedge the price of natural gas this winter. The possible use of options contracts would fix an element of gas cost within a defined range establishing a "ceiling" and a "floor". The combination of futures and options would provide the price protection for its customers which the Company was seeking at a reasonable cost.
- (d) 100% of all benefits or costs of any hedges would be flowed through directly to customers as gas costs. The Commission, in its Order in this Case, stated that since customers "receive the benefits realized through a hedging program, we continue to find that customers should bear the cost of such a program".

Market Conditions

Please refer to Exhibit A "Winter 2005-2006 NYMEX Strip" for a chart showing the winter month futures pricing from December 2004 to October 2005. After receipt of the KPSC order on July 20, 2005 Atmos Energy continued to actively monitor the market. US gas in storage was just high enough during the first half of 2005 to keep prices in check. Nevertheless, fundamental analysts continued to project that supply growth was not matching the higher demand growth which was tracking a healthy economy and growth in the power generation market segment. Beginning January 2005 storage balances were just slightly above the January 2004 levels. The supply excess expanded to over 300 Bcf in April and in June. With the arrival of warmer summer weather, the weekly injections steadily eroded that cushion. From early July the cushion consistently deflated putting upward pressure on natural gas futures prices.

The 2005-2006 winter strip rose steadily from \$7.87 on June 1 to \$10.83 on August 24, the week before Hurricane Katrina ravaged the Gulf Coast offshore production facilities. Two weeks later Hurricane Rita caused additional damage. The two storms initially took out over 8 Bcf per day of normal 10 Bcf per day Gulf production (See Exhibit B for details). As a result of the storm related supply concerns the winter strip rose to a record high of \$14.84 on October 5. Through the remainder of October the strip fluctuated in a range of \$13.25 to \$14.50.

Market participants' fears of a cold start to the winter season were tempered by warmer than normal weather from late October through the end of November. In an unusual pattern, storage injections continued several weeks into November in contrast to the normal pattern of injections. As a result, storage inventories ended November at 3.282

trillion cubic feet, substantially above the 3.2 trillion cubic feet generally considered as ample for the winter. By November 17 the remaining December 2005-March 2006 strip had fallen below \$12.50.

Winter 2005-06 Forecasts

Around the end of the first week of each month The Energy Information Administration of the U.S. Department of Energy publishes Short Term Outlook summarizing energy market conditions and activity. The price forecast is based on an econometric model employing numerous supply and demand variables. The table below summarizes EIA forecasts of estimated winter 2005-2006 spot natural gas prices.

WINTER 2005-06 FORECAST – EIA

Date	\$/MMbtu
August 2005	8.50
September 2005	11.00 - 13.00
October 2005	>\$12.00

Referencing Exhibit A, NYMEX prices for the Winter 2005-2006 strip typically traded at prices higher than those forecast by EIA.

Impact of Atmos Energy Storage

The Company develops seasonal summer and winter supply plans which set its storage injection and withdrawal levels. Historically, Atmos has planned to inject on essentially a ratable basis, both Company storage and pipeline storage, across the injection season (April through October). Withdrawals are similarly scheduled across the winter months, though weather patterns and deliverability are considered in the planned withdrawals.

Prior to the 2005 injection season Atmos Energy’s Kentucky operations added 1,750,000 mcf of behind-city-gate storage capabilities through a contract for East Diamond storage capacity. The addition raised the portion of normal winter sales met by storage withdrawals to approximately 67%. The weighted average cost of the total storage balances of 10,348,000 mcf at the end of October, 2005 was approximately \$8.15 per MMBtu. Giving consideration to the volatile and historically high winter month swap prices experienced during the short hedging implementation period, the Company believed the reasonable course was to rely on the lower priced storage gas to stabilize winter gas prices. Further consideration was given to the weighted average cost of storage gas in view of the winter price forecasts.

Conclusions

Market conditions during the implementation period from July 20 through October 31, 2005 were not conducive to executing cost effective hedges. However, with the Company's additional storage capabilities, which now equate to 2/3 of the total winter sales demand, Atmos Energy's objectives for stable and low prices are still achieved. The Company maintained its disciplined approach to executing hedges and believes its customers interests were best served by avoiding the prices available this past summer and fall. In fact, since November 1, 2005, market prices have moderated, and are below that which were available on the winter futures market during the implementation period.

The Company would be pleased to submit a season ending report, to summarize the actual market prices which occur during the 2005-06 winter period, for comparison to those futures prices available during the hedging implementation period.

Exhibit A: Winter 2005-2006 NYMEX Strip (Nov 05 – Mar 06) As Of Close 10/27/2005

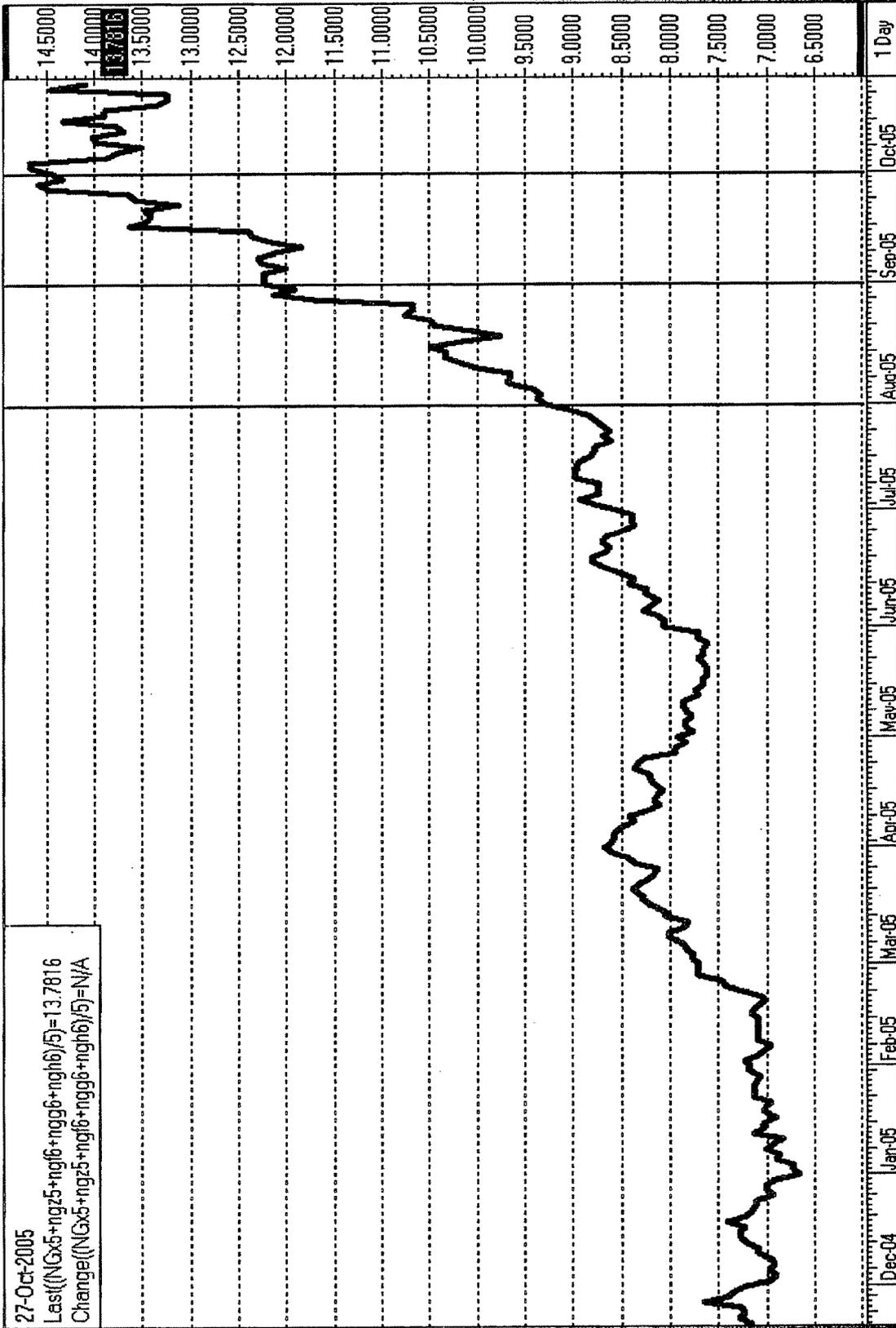


Exhibit B: Interim Report Case 2005-00175 Atmos Energy Kentucky Division



Hurricane Katrina and Rita Gas Production Shut-in

